

# Reinvesting profits from the beef operation

Lee L. Schulz, Assistant Professor and Extension Livestock Economist, Department of Economics, Iowa State University

Ask any veteran cattle producer about profitability and they likely will have several “I remember back in...” stories. It is well known that economic returns to cattle production fluctuate considerably over time and year-to-year and even within year swings can be quite extreme. When profits are high, producers must decide how to allocate these funds to capitalize on the good times. The key question for cattle producers to consider is “How do I reinvest profits from the prosperous times to remain profitable over the long-run when profits come back down?” Many investment options do exist and they are all very situational dependent and dependent upon the goals of the business.

## Keeping good records

The first step to profitability is good recordkeeping. Records give the information needed to make sound business decisions. The key financial statements – balance sheets, income statements, and cash flow statements – are very useful and critically important for analyze the financial position and success of a business. Likewise, these same statements can provide some useful benchmarking information through ratio analysis (e.g., liquidity, solvency, profitability, financial efficiency, repayment capacity). It is also important to note that there are several production-related reports and measures that are essential when analyzing a business (e.g., calf crop or weaning percentage, average weaning weight, average daily gain, total cost per pound of gain).

Keeping records with the necessary level of detail requires both a system that works for the business and the motivation and discipline to maintain the records. The incentive is the ability to increase profitability and improve the probability of long-run business success. Having good record systems in place will make recordkeeping much easier and analyzing records routinely will reinforce the need to keep good records to make informed business decisions.

## Expenses and debts

Profit is a simple concept that can get more complicated in reality (i.e., cover variable expenses while off-farm income covers overhead expenses, include payment for salary and living expenses in the calculation of profit). For simplicity, consider the basic formula for profit:  $\text{Profit} = \text{Revenue} - \text{Expenses}$ . Revenue must exceed expenses to turn a profit. No matter how high revenues are, it does not create an economically sustainable enterprise unless operational expenses can be covered.

In situations where high levels of expenses are incurred to generate large revenues, profitability may or may not occur. What does occur though is a large cash flow both in and out of the operation. Cash flow is an important consideration even for a profitable enterprise. Although an operation may be profitable for the year, the monthly and weekly cash flows may not balance revenues with expenses. For instance, cattle sales are often seasonal with many animals selling at once and creating large cash flows into the operation at those times. Yet production expenses are typically incurred prior to those sales creating a need to dig into cash reserves, liquidate assets to generate funds, or borrow money to meet expense obligations. Expenses may also not be evenly distributed throughout the year. Large purchases may occur at certain points in time, such as when feed is purchased and when groups of cattle are bought. Advance planning is crucial to properly manage cash flows without compromising operational goals or becoming overburdened with debt.

Certainly debt is an integral part of most businesses. Profitable production may provide an opportunity to pay down debt and reduce the interest load on the business. Cattle production, like agriculture in general, is a notoriously cyclical industry. Given the industry's previous runs of prosperity as well as challenging times, it is logical to assume leaner times will return. So lowering debt could be a favorable investment to profits in the long run. Reducing debt provides a guaranteed return on investment and leaves equity available for borrowing again in the future.

## Improving the operation

A major decision that should be made is whether to reinvest profits back into the cattle operation. Use caution when reinvesting back into the business during periods of high profits. It is important to make sure the long-term business plan indicates the need to make an investment. Many producers see high profits and invest, invest, invest in the hopes of many years of favorable returns. Then when profitability wanes, they liquidate, liquidate, liquidate, often on a lower market. A good investment ultimately produces profitability over the entire investment period (i.e., initiation through end of useful life),

whether short or long-term.

Once decisions about expenses, cash flow, debt, and investment are made, then it is important to focus on the specifics. If investment in the cattle business is the goal, there are several focus areas that may be worth considering. Some examples include: improving cattle genetics; improving the forage base; repairing, replacing, or expanding infrastructure; acquiring productive assets; investing in technology; and/or adjusting production activities (i.e., ensuring marginal costs equal the marginal benefits).

Investments should be made in the context of improving productivity and efficiency or lowering costs of the operation. This may require some form of benchmarking the operation, making comparisons against the industry for productivity and cost, and understanding—and making—the adjustments necessary to improve. Investments that improve productivity and efficiency or lower costs can pay dividends in future years and be part of the reason that even in the “bad years” some producers are making money.

## **Profits for personal use**

If one of the goals of the business is to produce profits for personal use, then profit taking is in line with the business's goals. Long hours and hard work deserve a reward when the income is there. Take the time and a few dollars to enjoy the blessings of an excellent cattle market. Other options for personal use include investing in an individual retirement account (IRA) and/or building or supplementing a savings account.

## **Summary and conclusions**

Much has been written about management strategies when times are tough. In reality, the most important decisions are often made when times aren't so tough. It may be tempting to splurge on unnecessary items that will not contribute to productivity and profitability. So, justify each transaction in the context of the goals of the business. If one of the goals is to produce profits for personal use, then profit taking is in line with operational goals. If the overriding goal is to grow the business, then consider strategies to acquire productive assets. If the ultimate vision is long-term profitability, then plan ahead for future times when generating profits might be more challenging.